Case Study on Strategic Debt Restructuring: A Step to Revitalise the Distressed Assets in the Economy

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Abstract: The leading financial sector problem at present in India is Non Performing Assets of public sector banks. Reserve Bank of India has initiated several steps; SDR (Strategic Debt Restructuring Scheme) is one among them. Mechanism of this scheme hovers around group of banks or Joint Lender Forum (JLF) committee comprises of the bankers who have lent loans to a stressed borrower. Condition for JLF initiative is being the non recovery of any money by a borrower during the last 60 days that is classified as the Special Mention Account 2. Corrective Action Plan (CAP) is working towards the restructuring of stressed assets. It also deals with the change of management or share transfer from the promoter to the banks. This step of RBI gives a strong footing to the banks to recover the debts and provide corrective shape. This empirical research paper is structured with the following objectives:

1. **To understand the reasons of bad debts**
2. **To understand the viability of financial diversification**
3. **To analyse the sick unit framework**
4. **To assess financial implications on the lender**
5. **To critically evaluate the sample companies in the study**

To achieve above objectives researchers have used secondary data with the help of qualitative tools for analysis.

Keywords: Bad debts, Distressed assets, Economy, SDR.

I. Introduction

Debt restructuring dates back to 2001. RBI came up with voluntary non statutory system based on debtor-creditor agreement and inter creditor agreement. This system was termed as Corporate Debt Restructuring under detailed guidelines to banks. It emerged with an objective to cover multiple banking accounts, syndication or consortium accounts, in which banks and institutions together have an outstanding aggregate exposure of Rs. 100 million and above. This voluntary agreement worked with principles of approvals by a majority of 75% creditors by value 25% to fall in line with majority decision. It worked under three tier arrangement ie., CDR Standing Forum, Empowered Group and Cell. This system is not applicable to those debtors who are involved in fraud or misfeasance even in a single bank. From its inception till September 2015, this system approved 530 cases for resolving. Only 87 being successful, 189 cases have failed & 257 cases are at various stages of implementation.

To enhance the system SDR was introduced with following differences:

- All the categories of assets as per the books of creditors are covered in CDR whereas in SDR only cases restructured by CDR and other exercise undertaken by companies.
- In CDR the existing debt are involved by increasing the repayment period and minimising the interest rate or giving fresh loans. SDR is approached to convert debt to equity by the lender.
- CDR framework works under three tier, whereas SDR has joint lenders forum to deal with conversion process.

Above comparison clears the working of SDR. Now let us understand why we need to deal with bad debts seriously. India's bad loan problem is really a concern as per the report by consulting editor and advisor of the leading bank, the average bad debts of public banks are 75.53% of their net worth and for some of the banks this figure is exceeded. This is the main concern that RBI and government have reasons to be worried. The band-aid approaches of our central bank and government towards the loans have the deep gash.

Following are the major reasons for emergence of bad debts:

- Corrupted Banking Officials
- Lack of Credit Appraisal Expertise
- Lack of Monitoring system of loans
- No Market Survey conducted before forwarding loans to big B giants
- More preference to balance sheet growth
- Misleading of economic scenario of 2008 recession and RBI Policy on credit

- Optical illusion of lower bad loans
- Disconnect between Rating & loan disposal
- Status of legal framework

Like, credit transaction is based on mutual agreement with parameters on terms of credit including amount of credit, interest rate, maturity of loans, frequency of loan servicing and collateral. However incase of default there should be strict norms to be imposed on sanctioning authority and borrower that can build strong wall between the banks and defaulters.

As per the analysis by the rating firm ICRA Ltd, gross bad loans of Indian banks in 2007 have been 9.5% of their loan portfolio, out of which 5.5% are net loans. Banks are also suffering with optical illusion ie., writing down the bad loans and taking out the same from balance sheet, by parking them aside. As and when the money is recovered, banks add the amount to their profits. In Mar 2017, public sector banks had 11.4% of gross bad loans and private sector banks had 4.2%.

Role of Rating agencies should not be missed. Consideration of credit rating reports before granting the approval will reduce the problem to a larger extent.

If we quote an example of Spain's largest lender Banco Santander SA has previously announced taking over of critical Banco Popular Espanol SA. It had plans to rights issue to infuse capital and provide for the bad loans of Banco Popular which is 6th biggest bank. European central bank is the major factor behind this rescue act. This arrangement was stitched at the speed of light and impact on stock market was almost nil and bank stock rose in Europe by winding down the sick bank.

To compare the above case with our Indian state owned banks, following factors need to be assessed on the basis of pockets of strength:

- Retail Loans
- Low cost savings & current accounts
- Non-core assets
- Networking of branch

Now the question for thought in action based speed or band-aid approach.

New ordinance of RBI believes in the forming oversight committees and encourage banks to trim and cut hair. RBI now can move to court against the defaulter.

Following are the some of the cases in discussion

A. Jindal Steel and Power

Undisclosed debt outstanding of Jindal Steel and Power plant in Chattisgarh Project is also a case of SDR in the event of a default. Board has approved the decision related to 1200 megawatt power plant at Tamnar.

In September, JSPL's total consolidated debt was at Rs.42,534.04 crore. According to Capitaline data, Jindal Power's stand-alone debt was at Rs.3,319.10 crore in 20-2014. Company is looking for different options to settled down the case.

B. IVRCL Ltd.

IVRCL was unable to payback its debt and opted for CDR to repay their loan. January 2014 it approached the CDR Cell, Cell granted approval to restructure the loans, working capital loans also in fresh loan assistance by banks. IVRCL failed to revive, SDR was adopted in November 2015 with lenders owing 78 percent of equity shares inthe company. As per company officials, currently its lender is initiating the resolution process against the company.

C. Lanco Infratech Ltd.

Converting debt option to equity will try to heal the lenders (ICICI, Andhra Bank, Axis, OBC, PNB etc) and it also provides a choice with a stake of 65.83%. (equity base). Basically this company is handling power, real estate and reconstruction business. Debt restructuring revisal is approved by both public and private sectors lenders ie., Rs. 11,155 crores and conversion of Rs. 3024 crores loan into equity. Due to delay in the proceedings by lenders it is still under review.

D. Electrosteel Steels

Funds were raised to take care of under construction plants Greenfield Intergrated Steel and Ductile Iron Pipe Plant in Jharkhand. Company suffered and claimed that it did not have sufficient money to payback. CDR was initiated, however it was unable to proceed further. Currently four major players including Tata Steel have submitted the bids.

E. Neesa Leisure Ltd.

Being in hospitality sector Neesa L Ltd agreed to CDR with the aggregate exposure of 400 crs. Its lenders include ICICI, Axis and SIDBI. Rating agencies downgraded its term debt servicing and also non convertible debentures. Currently company is requested to reschedule the process.

F. Gammon India Ltd.

Rupee depreciation and decreased economic scenario hit the infrastructure company, inability to act upon the risk of external economies of scale this engineering and Construction Company was adversely affected. CDR was approved for Rs. 13,500 croress in 2013. In this case, banks have a fund based exposure of Rs 3500 crore and leading lenders were ICICI Bank ltd and Canara Bank Ltd. To sum up under the SDR norms introduced by the RBI in June, banks are allowed to acquire a 51% stake or more in companies where debt restructuring fails to revive them. The banks then have to sell the stake to a new promoter within 18 months. As per the stock exchange notifications by these companies have invoked SDR packages. Banks have started pitching assets which are under SDR to private equity firms.

II. Management Lessons

Two folded analysis can be done on the SDR. One part being the analysis from the lender point of view and on the other hand how companies can avoid getting into such situations.

Many reviewers feel that SDR may be helpful to few lenders ,however it may not give complete solution to the problem.

But when we talk about the companies point of view or what may be the strategies that can minimize the problem of getting into default, above cases show cause the following factors.

- Debt capital ratio
- Rational Financial Planning
- Focus on Sales turnover
- Effective management of Working Capital
- Preparing for Reserves during recession in business
- Understanding the market movement
- Positive utilization of Economies of Scale
- Ethical commitment to interest payment
- Collateral Arrangements

Companies should focus on leverage ratio to understand the debt and its effective uses in capital employed. Because this works as metric to indicate overall financial goodness and stability, it also shows whether debt money is working favourably or not. Continuous check on this factor will minimize future complications of default.

Financial planning is aid to understand the positive and negative areas of business and plan accordingly. Due market survey should be conducted by the companies before planning for loans and its utility, most of the above cases show that bad debts are accumulated due to market crash or misunderstanding of market while planning for business or its extension.

Sales turnover is one more factor that pushes the companies to default, profit is directly linked to sales, a downfall in sales is a sign for company to revamp its sales force. Timely analysis will minimize the upcoming financial problems.

Most of the time funds are stuck in the working capital and it hovers around inventory and debtors. Maintaining unnecessary and high level non working inventory will lead to misuse of funds on wrong place, effective circular flow should be done to convert the inventory into liquidity. Cash management becomes simpler by effective synchronization among departments. In case of IVRCL funds were stuck more in this arena and managers were unable to rectify at right time.

Creation of Reserves is one more option to meet the uncertain situations in fund management. By doing this companies will have breathing time to support bad times.

In case of infra based companies in this case had wrong market timing to throw the funds in market due which the companies were unable to reap the returns. Like during demonetization real estate was hit very badly due to non cash transactions.

Economies of Scale both internal and external are favourable to companies only if they are tapped at right direction. Like vertical or horizontal managerial efficiencies helps in cost reduction by minimising the expenses. Tapping the marketing and financial economies will improve the fund performance. Likely these economies of scale will help the company to grow and reap the benefits.

Ethical Commitment to make interest payment on borrowed funds acts as damper to expand by borrowing. Ethical commitment is required avoid default. Many times studies show that companies are willing to avoid payment on time.

Collateral arrangements: We may quote an example of following case of coming out of SDR initiative by collateral planning. R INFO Com, few months back, wanted to sell the assets so that it could restructure and minimize the burden of debt. Its domestic lenders and company agreed to initiate SDR, R INFO Com tried to initiate talks with Brookfield Infrastructure and Aircel to merge its wireless business and mobile towers business respectively. However there was no success. Double trouble came with fall in share price due to obsolete technology and default risk as well deadline for conversion. R INFO Com defaulted on outstanding dollar bonds so it faced the charges of insolvency by China Development Bank. One more insolvency petition came across by Manipal Tech and Ericson who were operational creditors.

R INFO Com came out with the plan to sell its DTH Subsidiary, Reliance BIG TV to Veecon Media. RCom would exit the SDR plan with a zero write off to lenders and resolve the issues. Company has considered measures to minmize the debt by monetizing its wireless business and selling land DAKC, so none of the debt will be converted into equity under this plan. It has also planned to cut some part of debt by prepayment after the asset monetization and transfer of spectrum liability.

III. Conclusion

SDR has seen as a step to revitalize the distressed assets in the economy. Meanwhile, reviews regarding SDR termed it as damp squib, as the scheme empowers the lenders/banks to tackle bad debts, finding the buyer is not easy, in case of Gammon recovery of debts being fortunate with lot of struggles by the lenders. But in majority of cases it's an enormous task. As per comments of Boston Consulting, SBI's Chairperson and several other groups (i) loan documentation process is a loophole (ii) Resistance of companies to new investors (iii) Legal Framework to deal with problem is not defined (iv) Limitation of Personnel to manage SDR process and (v) Change Management are the major areas that will hinder the judgment based step of SDR. However, innovative steps will have its own pros and cons that can be revised and reviewed to bring the success as the objective of every economic initiative to bring prosperity to nations and rebuild the positive economy.

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